MONTEREY ENERGY CORP.

First Annual Report 1997

Corporate Profile

Monterey Energy Corp. is a Calgary based, Canadian controlled public junior oil and gas company actively engaged in hydrocarbon exploration and production in Western Canada. The Company's mandate is to build assets by exploring for and developing quality oil and gas reserves. The mandate is also to acquire and enhance the value of under-developed producing and non-producing oil and gas properties both domestically and internationally.

The Company was listed for trading on The Alberta Stock Exchange on August 11, 1997 under the symbol "MOE".

1997 Highlights

Financial

Gross Revenue	$	25,368
Cash Flow (Loss) From Operations	$	(91,841)
Per Share	$	(0.018)
Net Earnings (Loss)	$	(96,861)
Per Share	$	(0.019)
Capital Expenditures	$	446,605
Working Capital	$	694,882
Long Term Debt	$	NIL
Shareholders' Equity	$	1,136,467
Shares Outstanding		6,073,334

Operating

Production		
Oil (bbls/d)		15
Sales Price ($/bbl)		27.17
Average Netback ($/bbl)		20.01
Reserves, Proven		
Oil (mbbls)		83.9
Discounted at 15% Before Tax	$	722,200
Land Holdings		
Total Acres		160
Net Acres		160

Notice of Meeting

The Annual General Meeting of the Shareholders of Monterey Energy Corp. will be held on June 17, 1998 at 2:00 p.m. at the Conference Center, SunLife Plaza, +15 Level located at 140 - 4th Ave. S.W., Calgary, Alberta.

Shareholders unable to attend are encouraged to complete and return the accompanying form of proxy.

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President's Message

The management of Monterey is pleased to present the Company's first Annual Report to our shareholders. Although this report represents less than one-half year of operations as a publicly listed Company, 1997 marked significant achievements for Monterey.

The Company was incorporated in April, 1997, and was initially capitalized by the founders via the issuance of 4 million common shares of the Corporation at $0.075/share for total proceeds of $300,000. The Corporation completed its Initial Public Offering as a Junior Capital Pool Company in July 1997, raising an additional $200,000 via the issuance of 1.33 million common shares of the Corporation at $0.15/share.

On October 31, 1997 the Company held a Special Meeting of Shareholders which approved the "Major Transaction" of the Corporation. This transaction was the acquisition of a 100% working interest in a producing Swan Hills oil well for 400,000 Monterey shares priced at $0.25 per share, together with the assumption of approximately $450,000 of associated bank debt. The acquisition of this long life, light oil property accounts for the Company's current production of about 15 bopd.

In late December 1997, the Company raised an additional $855,000 via the issuance of 2,510,000 flow-through special warrants at $0.30 per warrant and 340,000 flow through common shares at $0.30/share. These proceeds will be used for oil and gas exploration and development in 1998 on qualifying expenditures renounced to our investors in the 1997 tax year. It is expected that additional funds will be raised in 1998, the amount and timing of which will be subject to the requirements of the Company and market conditions.

Having completed the start up phase of the Company and raised additional capital with which we can begin to grow the asset base through the drill bit, Monterey is well positioned to vigorously pursue its growth objectives in 1998.

The fourth quarter of 1997 appears to have marked the end of the very bull market experienced by the industry in the preceding seven quarters. March 1998 saw oil prices drop to $20.25 per bbl from the $26.10 per bbl we were experiencing in July, 1997. Heavy oil differentials widened throughout the year, and are currently standing at over $7.00 per bbl. Gas prices held relatively steady throughout the year, allowing producers to expect a continuing strong gas market for the upcoming year. Management believes that the market changes experienced by the industry in 1997 will present a wealth of acquisition and farm in opportunities for emerging companies such as Monterey. Management has made a conscious decision to put our time and energies towards opportunities which have been primarily self-generated, or internally identified. It is our belief that in identifying opportunities before they have been made publicly available, we can increase our chances of consummating a deal, and the terms of the deal are likely to be more favorable for the Company.

Management of the Company intends to adhere to this philosophy with respect to identifying both acquisition, and drilling opportunities to achieve our short term goal of 300-500 BOE/D within the next 12 months. Monterey is in the process of generating a portfolio of properties which have an above average reserve life index, are balanced equally between light oil and natural gas, and will yield high net backs so as to lessen the effects of commodity price fluctuations. Initially, the Company will look to participate in projects with early cash flow, and take the highest reasonable working interest consistent with our risk parameters and potential reward. We will look to inventory prospects which are attractive in the long term, but are currently out of phase with the early cash flow objective as a result of a low commodity pricing cycle or a high cost cycle. Monterey will endeavor to build early on its successes in a prospect in order to enhance the technical and operating efficiencies associated with a "core area" concept. Finally, Monterey is in the process of developing alliances with companies with synergistic needs and the ability to reciprocate in identifying quality prospects so as to maximize our efforts with a minimum amount of time.

During the first quarter of 1998, the management team of Monterey have spent a considerable amount of time building relationships with industry joint venture partners. To date, these efforts have resulted in our participation in the Heathdale prospect, as well as the Jarrow farmin. We expect these relationships to yield significant prospects in the future.

1998 promises to be a year of opportunity and growth for Monterey, and the management and directors are firmly committed to the successful development of your Company. I would like to thank the shareholders for their continued confidence and support, and I look forward to reporting on the success of some of our initiatives in the upcoming months.

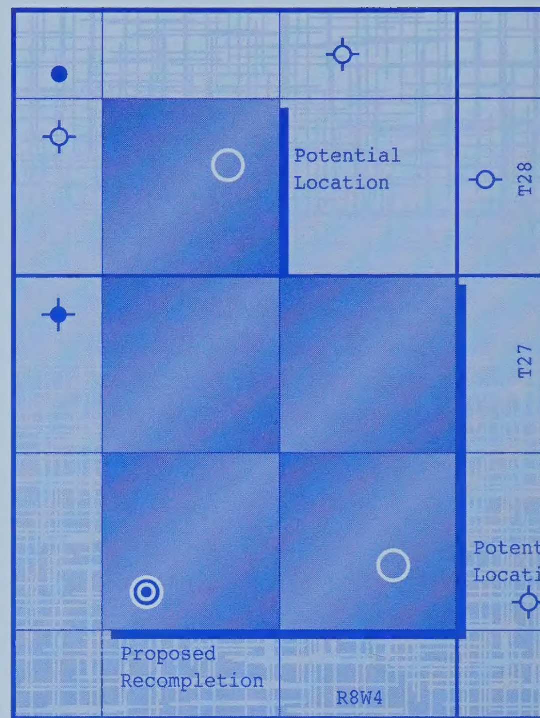
Don Campbell

Donald G. Campbell
President & CEO

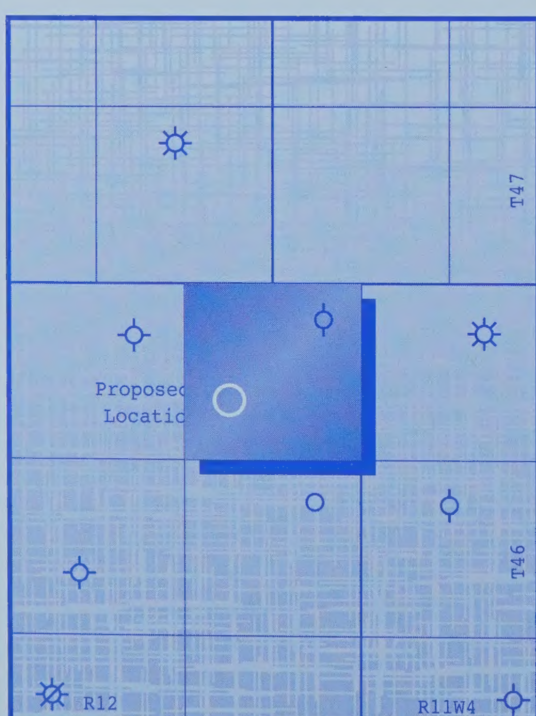
1998 promises to be a year of opportunity and growth for Monterey, and the management and directors are firmly committed to the successful development of your Company.

Heathdale

The Company has acquired a 16.25 - 25.00% working interest in 5 sections of land in the Heathdale area of Alberta. The Company plans to reenter the 3-26-27-8W4M well during the first quarter of 1998 and recomplete the well for bypassed Viking sand gas potential. Up to two additional locations may be drilled on the lands this year, pending the results of the reentry and additional seismic acquisition. The lands are ideally located in an area of known Viking potential, and are within a mile of a gathering system.



Monterey has focused its efforts on generating prospects which will convert the equity capital raised at the close of 1997 into cash flow for 1998.



Monterey Lan
Location
Oil
Gas
Abandoned

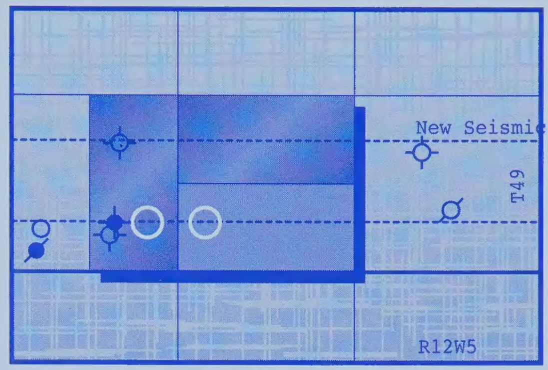
Jarrow

The Company has committed to drill a 100% working interest well on a farmin basis in the Jarrow area of east central Alberta to test a Colony gas sand anomaly located on a recently shot seismic line. The well, scheduled to spud this spring, will be taken down to the Paleozoic, as the area is known for its multi-zone gas potential. The area also has a well developed gas gathering infrastructure in place, and there are several options for an early tie in of the well.

Pembina

Monterey has a 15% working interest in 640 acres of land in the West Pembina area of west central Alberta, and an adjoining 320 acres under option, all prospective for light gravity oil from the basal Belly River sands. The 7-4 well drilled in the late 1970's as a Devonian test encountered a similar basal Belly River section to existing nearby basal Belly River production, and tested a small amount of oil on recompletion before it was abandoned. The interpretation of our recently shot seismic program suggests the lands have potential for several drilling locations.

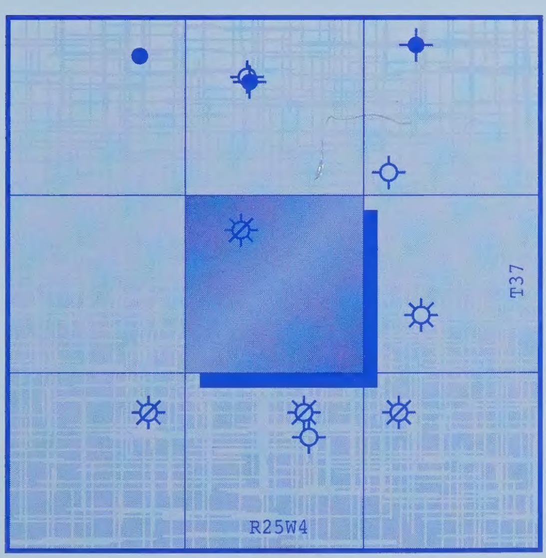
The Company intends to spud the first well in May of this year.



W. I. Lands

Option Lands

We have concentrated our initial efforts in the southern half of the province of Alberta, as year round accessibility lowers the cost of exploration, as well as future operating costs.



Joffre

Monterey has recently completed the acquisition of a minor land package from a large producer in the Joffre area of central Alberta. Along with a lower Mannville gas recompletion prospect came a 15% gross overriding royalty in a section of land with a cased Viking gaswell which production tested at 568 mcf/d, but has not yet been tied in. The Company intends to work with the operator in order to get this well on production as soon as possible.

Monterey Lan

Location

Oil

Gas

Abandoned

Management's Report

The information contained in this Annual Report and the accompanying financial statements and other financial information as well as the financial reporting process that produces such statements is the responsibility of Management.

Management maintains a system of internal accounting controls designed to reasonably assure that transactions are appropriately authorized, that relevant and reliable financial information is produced in a timely manner, and that the assets of the Corporation are adequately safeguarded.

The Audit Committee of the Board of Directors, which includes two non-management directors, has reviewed the financial statements including notes thereto, with management and John Powell Professional Corporation (the Auditors), and has reported to the Board of Directors.

The financial statements, upon the recommendation of the Audit Committee, have been approved by the Board of Directors.

Donald G. Campbell
President

George P. Bowley
Vice President

Auditors' Report

To the Shareholders of Monterey Energy Corp.

I have audited the balance sheet of Monterey Energy Corp. as at December 31, 1997 and the statements of loss, deficit and changes in financial position for the eight months then ended. These financial statements are the responsibility of the company's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1997 and the results of its operations and the changes in its financial position for the eight months then ended in accordance with generally accepted accounting principles.

John Powell Professional Corporation
Chartered Accountant

Calgary, Canada
April 17, 1998

Balance Sheet

At December 31, 1997

	$
Assets	
Current Assets	
Cash and short-term deposits	704,777
Accounts receivable	17,372
Income taxes recoverable	1,814
Inventory	1,855
Prepaid expenses	1,150
Total current assets	726,968
Capital Assets (Note 2)	6,365
Petroleum and Natural Gas Properties (Note 3)	435,220
	1,168,553
Liabilities	
Current Liabilities	
Accounts payable	32,086
Shareholders' Equity	
Special Warrants (Note 4)	667,226
Share Capital (Note 5)	566,102
Deficit (Statement 2)	(96,861)
Total shareholders' equity	1,136,467
	1,168,553

ON BEHALF OF THE BOARD:

Timothy S. Hoar
Director

Donald G. Campbell
Director

Statement of Loss and Deficit

MONTEREY ENERGY CORP.

For the Eight Months Ended December 31, 1997

	$
Revenue	
Oil and gas sales, net of royalties	22,195
Interest	3,173
Total revenue	25,368
Production and Operating Costs	3,790
Net Operating Revenue	21,578
General and Administrative Expenses	
Bank charges and interest	4,140
Depletion and amortization	5,020
Listing fees and transfer agent	8,377
Office	22,994
Other investigation costs	25,006
Professional fees	25,654
Rent	14,355
Salaries and benefits	22,306
Expense recoveries	(9,413)
Total expenses	118,439
Net Loss for Period Representing Deficit End of Period	96,861
Net Loss Per Share (Note 6)	0.019

MONTEREY ENERGY CORP.

For the Eight Months Ended December 31, 1997

	$
Operating Activities	
Net loss for the period	(96,861)
Add items not affecting cash	
Depletion and amortization	5,020
	(91,841)
Changes in other working capital elements	
Accounts receivable	(17,372)
Income taxes recoverable	(1,814)
Inventory	(1,855)
Prepaid expenses	(1,150)
Accounts payable	32,086
Net cash used in operating activities	(81,946)
Investment Activities	
Purchase of capital assets	(7,485)
Capitalized oil and gas costs	(439,120)
Net cash used for investment activities	(446,605)
Financing Activities	
Proceeds from special warrants, net	667,226
Proceeds from shares issued, net	566,102
Net cash from financing activities	1,233,328
Increase in Cash during the Period	704,777
Cash Beginning of Period	—
Cash End of Period	704,777

December 31, 1997

1. Significant Accounting Policies

Summary of Significant Accounting Policies

The financial statements of Monterey Energy Corp. (the "Company") have been prepared in accordance with generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements necessarily involves the use of estimates and approximations which have been made using careful judgment. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

Incorporation and Description of Business

The Company is a public company incorporated under the laws of the province of Alberta and is engaged in the production, development and exploration of oil and natural gas principally in Canada.

Petroleum and Natural Gas Properties

The Company follows the full cost method of accounting for petroleum and natural gas properties in accordance with the Accounting Guideline for full cost accounting published by the Canadian Institute of Chartered Accountants. All costs of exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenses, lease rentals on undeveloped properties, costs of drilling both productive and non-productive wells, all technical consulting costs directly related to exploration and development activities and lease and well equipment. All other general and administrative costs and interest costs are expensed.

Proceeds from disposal of properties are normally applied as a reduction of the cost without recognition of a gain or loss except where such a disposal represents a major disposition of reserves.

Depletion of petroleum and natural gas properties and amortization of lease and well equipment are calculated on the unit-of-production method and based upon estimated proven reserves as determined by the Company.

Substantially all of the exploration and production activities of the Company are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

Future Site Restoration Costs

Estimated future removal and site restoration costs, net of expected recoveries, are provided for over the life of the proved reserves on a unit-of-production basis. Costs are estimated each year by management based on current regulations, costs, technology and industry standards. The annual charge is included in depletion and amortization expense and the actual removal and site restoration expenditures are charged to the accumulated provision account.

Financial Instruments

Financial instruments of the Company consist mainly of the cash, term deposits, accounts receivable and accounts payable. Except where disclosed otherwise, as at December 31, 1997 there are no significant differences between the carrying values of these amounts and their estimated market values.

Measurement Uncertainty

The amounts recorded for depletion and depreciation of the petroleum and natural gas properties and for site restoration and abandonment are based on estimates of reserves and future costs. By their nature, these estimates and those related to the future cash flows used to assess impairment, are subject to measurement uncertainty and the impact on the financial statements of future periods could be material.

Flow-through Shares

The Company has financed a portion of its exploration and development activities through the issue of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits to the Company, the carrying value of the petroleum and natural gas properties acquired and the shares issued are recorded net of the tax benefits renounced to subscribers.

Ceiling Test

The carrying value of the Company's petroleum and natural gas property and equipment is compared to a calculated ceiling amount based on estimated undiscounted future net revenue derived from proven reserves net of financing costs, production related general and administrative costs and income taxes.

Administrative Expenditures

Administrative expenditures relating to non-exploration activities are expensed.

Capital Assets and Amortization

Capital assets are recorded at cost and amortization of capital assets has been recorded using the declining balance method at the annual rates disclosed in Note 2, which are designed to amortize the cost of the capital assets over their estimated useful lives.

Income Taxes

In accordance with generally accepted accounting principles, the Company follows the deferral method of tax allocation. Under this method, the provision for income taxes is determined from the income reported on the financial statements rather than from the Company's income for tax purposes. Also under this method, income tax recoveries on losses are set up only when it is virtually certain that these losses will be recovered in future years.

2. Capital Assets

		$		
	Cost	Accumulated Amortization	Net Book Value	Rate
Office equipment	5,735	860	4,875	20%
Computer equipment	1,750	260	1,490	30%
	7,485	1,120	6,365	

3. Petroleum and Natural Gas Properties

	$
Petroleum and natural gas leases and rights including exploration, development and equipment thereon, at cost	439,120
Accumulated amortization and depletion	(3,900)
	435,220

4. Special Warrants

	Number of Shares	Consideration $
Proceeds on issue of special warrants	2,510,000	753,000
Commissions paid	—	(56,475)
Professional fees	—	(29,299)
	2,510,000	667,226

Pursuant to an offering memorandum dated December 1, 1997, the company issued 2,510,000 flow-through special warrants at $ 0.30 each. Each special warrant is exercisable into one flow-through common share for no additional cost on the earlier of the fifth business day after a receipt for a final prospectus is obtained from the Alberta Securities Commission or on the first anniversary of the closing of the offering.

The Income Tax Act (Canada) allows a company to issue "flow-through" shares/warrants where the company renounces its Petroleum and Natural Gas Properties costs for income tax purposes to the subscriber of its shares or warrants. As of December 31, 1997, the company renounced eligible costs of $ 753,000 resulting in a decrease of share value of $ 335,989. The reductions will be charged against the share capital and the company's oil and gas properties when the properties are acquired.

5. Share Capital

Authorized -

Unlimited Common Shares

Unlimited Preferred Shares issuable in series

	Number of Shares	Consideration $
Issued -		
Opening balance	—	—
Founding shares issued	4,000,000	300,000
Prospectus	1,333,334	200,000
Share issue costs	—	(44,927)
Major transaction (Note 7)	400,000	9,029
Private Placement (flow-through)	340,000	102,000
	6,073,334	566,102

Stock Options

The company granted stock options under a stock option plan to its directors as follows:

	# of Options Granted	Exercise Price/Share $	Expiry Date
Donald G. Campbell	200,000	0.15	April 23, 2002
George P. Bowley	200,000	0.15	April 23, 2002
Gerald L. Donaldson	66,667	0.15	April 23, 2002
Timothy S. Hoar	66,666	0.15	April 23, 2002

Agent's Options

Pursuant to an agency agreement, the company granted options to McDermid St. Lawrence to acquire up to 133,333 common shares at a price of $ 0.15 per share. These options expire February 11, 1999.

Flow-Through Shares

The private placement shares are "flow-through" shares. As of December 31, 1997, the company had renounced $ 102,000 in eligible expenditures resulting in a decrease in share value of $ 45,512. The reductions will be charged against the share capital and the company's oil and gas properties when the properties are acquired.

Escrow Agreement

Pursuant to escrow agreements dated July 19, 1997 and October 31, 1997, there are 4,400,000 shares of the company being held in escrow. At the discretion of the Alberta Securities Commission, these shares may be released from escrow as follows:

1/3 of shares escrowed	November 28, 1998
1/3 of shares escrowed	November 28, 1999
1/3 of shares escrowed	November 28, 2000

6. Net Loss Per Share

The calculation of Net Loss per Share is based on the weighted-average number of shares outstanding. The fully diluted net loss per share has not been presented as it is anti-dilutive.

7. Related Party Transactions

On October 31, 1997, as part of the Company's major transaction, the company purchased all the issued and outstanding shares of Hidden Reef Resources Ltd. and New London Resources Limited, for a total of 400,000 common shares, and immediately wound up the operations of these two companies into Monterey Energy Corp.

New London Resources Limited was owned 50% by Donald Campbell, President and director of the company and 50% by Sherry Campbell. Hidden Reef Resources Ltd. was owned 60% by George Bowley, Vice-President and director of the company and 40% by Melinda Bowley.

8. Income Taxes

The company has $ 158,713 in non-capital loss carry-forwards which have not been recognized in the financial statements but are available to reduce future income taxes. These losses, if not utilized, will expire as follows:

2003	$ 12,550
2004	146,163
	$ 158,713

9. Commitments

As at December 31, 1997, future minimum lease payments under the lease for office space are as follows:

1998	$ 25,341
1999	10,559

Pursuant to an offering memorandum date December 1, 1997, the Company has committed to issuing 251,000 options at an exercise price of $ 0.30 per share to its agent. These options will be granted upon of the completion of the prospectus.

Corporate Information

MONTEREY ENERGY CORP.

Board of Directors

Donald G. Campbell *
Calgary, Alberta

George P. Bowley
Calgary, Alberta

Timothy S. Hoar *
Calgary, Alberta

Gerald L. Donaldson *
Calgary, Alberta

* Member of Audit Committee

Officers

Donald G. Campbell
President and
Chief Executive Officer

George P. Bowley
Vice-President and
Chief Operating Officer,
Secretary

Abbreviations

bbl	barrel
bbls/d	barrels per day
bopd	barrels of oil per day
mbbls	thousands of barrels
BOE	barrels of oil equivalent (1 bbl = 10 mcf)
BOE/D	barrels of oil equivalent per day
mcf	thousands of cubic feet
mmcf	millions of cubic feet
mcf/d	thousands of cubic feet per day
mmdf/d	millions of cubic feet per day
Ngls	Natural gas liquids
ARTC	Alberta Royalty Tax Credit

Head Office

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Calgary, Alberta T2P 3P2
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Fax: (403) 237-9411

Banker

The Bank of Nova Scotia
240 - Eighth Avenue S.W.
Calgary, Alberta T2P 2N7

Transfer Agent and Registrar

Montreal Trust
710, 530 - Eighth Avenue S.W.
Calgary, Alberta T2P 3S8

Auditor

John Powell Professional Corporation
602, 1000 - Fifth Avenue S.W.
Calgary, Alberta T2P 1V4

Independent Engineers

Chapman Petroleum Engineering Ltd.
750, 840 - Sixth Avenue S.W.
Calgary, Alberta T2P 3E5

Legal Counsel

Hoar, Lee & Boers
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Calgary, Alberta T2P 3N4

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